

**Oregon University System  
Investment Report  
Year Ended June 30, 2004  
Management's Discussion and Analysis**

The following Management's Discussion and Analysis (MD&A) provides an overview of investment management of the Oregon University System (OUS). It also provides a brief summary of the Investment Committee actions and current year performance for the year ended June 30, 2004. The Oregon University System is comprised of the following four-year public universities: Eastern Oregon University, Oregon Institute of Technology, Oregon State University, Portland State University, Southern Oregon University, University of Oregon, Western Oregon University, and Chancellor's Office.

**Background**

The Oregon State Treasurer is the designated cash management and investment officer for all funds held by agencies of the State of Oregon. Interest earnings from agencies' cash balances are retained by the State of Oregon unless specific provisions have been made within the Oregon Revised Statutes (statutes) to allow retention of interest earnings on those funds by the agency. In addition, the statutes specify the uses that may be made of the interest earnings.

OUS has authority granted within the statutes to retain interest earnings on the following types of funds: Endowments, Donations, Bond Building Funds, Bond Sinking Funds, Oregon Lottery Capital Construction Funds, Auxiliary Enterprise Building Repair and Equipment Replacement Reserves, Student Activities Funds, Invention Fund, Student Loan Fund, OSU and UO Land Grant Funds, Oregon Engineering Investment Fund, and Agency and Deposit Funds.

**Investment Options**

The investment options available for OUS vary based on the type of fund and the provisions for investment defined within the statutes. All funds may be invested in the Oregon State Treasury Float pool, which purchases short-term investments and prorates earnings among the agencies. In addition, most funds may also make other investments with the State Treasurer within allowable investment options for public funds as defined in ORS 293.701 to 293.820. The option to purchase investments is exercised when funds are available for longer-term investment to achieve higher returns. OUS also invests Pooled Endowment Funds, through the State Treasurer and Oregon Investment Council, in managed funds held with contracted investment managers. Additionally, the Separately Invested Endowment Fund holds individual investments as determined by the terms of the endowment.

## **Oversight of Investments by the Board and Investment Committee**

As mentioned previously, the Oregon State Treasurer is the designated cash management officer for the State of Oregon. The State of Oregon has also created an Oregon Investment Council (OIC), with the Treasurer as investment officer, to establish policy for the investment of state funds. The Oregon State Board of Higher Education (Board) works together with the Treasurer and the OIC to approve the Board's "Investment Objectives and Policy Guidelines" (Policy). Together, they also define the asset allocation for investment of OUS endowment funds and select investment managers with which OUS endowment funds are invested.

During the 2004 fiscal year the Board went through a reorganization process, which resulted in a substantially new Board membership and the disbanding of the old committees, including the Investment Committee. As a result of these changes, oversight for investments was transferred to the newly formed Finance/Budget/Audit/Personnel/Real Estate Standing Committee of the Board.

### **Investment Objectives – Pooled Endowment Fund**

The OUS Pooled Endowment Fund is a permanent fund expected to operate in perpetuity, and therefore these funds are invested long-term. The investment objective is to protect the principal of the funds and produce reasonable total return with emphasis on capital appreciation. The Policy governs both investment and expenditure of the funds to maintain future purchasing power.

### **Role of OUS Investment Managers – Pooled Endowment Fund**

OUS works with Treasury to contract with several investment managers to invest the Pooled Endowment Funds. The distribution of assets among the investment managers reflects several factors including the Board's investment strategy related to asset allocation. The performance of each fund is evaluated periodically based on the total return of the fund compared to a pre-defined benchmark that matches the investment goals of that fund.

### **Comments On Current Year Performance**

Overall performance of the Pooled Endowment fund: The Total Pooled Endowment Fund return for fiscal year 2004 was 16.0%, which outperformed the policy benchmark return of 15.7%. The ten-year average performance of the Total Pooled Endowment Fund is 9.9%.

Overall performance of other investments: U.S. Treasury Notes and FNMA Securities in the Current Donation Fund and the Building and Equipment Replacement Reserve fund yielded an annual rate of between 1.281% and 5.35% until they were called or matured. As terms of the purchase contract allowed, the investment in FNMA securities was called on March 12, 2004. The U.S. Treasury Notes matured in 2004. All Current Donation

Funds and Building and Equipment Replacement Reserve funds are now invested in the State Treasury's Short-Term Investment Pool.

Overall performance of other funds: The average return of all other funds invested in the State Treasury's Short-Term Investment Pool was 1.28%.

Detailed performance information for all funds is included in the following report.

## **DEFINITIONS OF TERMS**

**APPRECIATION (DEPRECIATION)** - Change in market value of the investments in the portfolio.

**THE COMMONFUND** - A non-profit corporation formed to provide investment services exclusively for colleges, universities, and independent schools.

**CURRENT DONATION FUNDS** - Gifts received which do not qualify as true endowments and the Board has not designated as Quasi-Endowments. Oregon Revised Statutes authorize the investment of these funds with earnings to be credited to the Oregon University System.

**ENDOWMENT FUNDS** - Consist of two types of gifts. True Endowments are donations received with the stipulation that the principal must remain inviolate in perpetuity with only the income to be utilized in accordance with any donor restrictions. Quasi-Endowments are funds which the Board has designated to function in the same manner as true endowments. Principal is available for expenditure at the direction of the Board.

**ENDOWMENTS, POOLED** - Endowments that do not have restrictions on how the principal is to be invested. Each endowment “owns” a specified number of units within the total of all endowment funds to be invested. A value is assigned to each of the units in the fund based on the current market value of the total fund. The total fund is invested and yield is distributed to the “owners” on the basis of the number of units “owned.”

**ENDOWMENTS SEPARATELY INVESTED** - Donations received which qualify as endowments but, due to donor restrictions, assets must be held as investments separate from other endowments, or assets are temporarily invested in property, which is not available for inclusion in the pooled endowments.

**EQUITIES** - Common stock and convertible preferred stock or debentures.

**FIXED INCOME** - Corporate bonds, securities issued by the U. S. government or Federal agencies, and nonconvertible preferred stock or debentures. Rate of income is determined at time of purchase. Market value fluctuates due to increases or decreases in overall market interest rates relative to interest rate on the given security.

**PLANT FUNDS** – Bond sale proceeds (bond building funds), moneys set aside for debt service on bonds (sinking funds), and moneys reserved for the repair of buildings and the replacement of equipment for auxiliary enterprise activities such as dormitories, student

unions, etc. Oregon Revised Statutes authorize investment of these funds with earnings to be credited to the Oregon University System.

**REMAINDER INTERESTS** – Trust instruments that designate the Oregon University System as beneficiary of the interest remaining after all the other designated distributions are made. Since there is no objective method to value these interests, they are recorded at \$1.00 in order to recognize their existence in the accounting records.

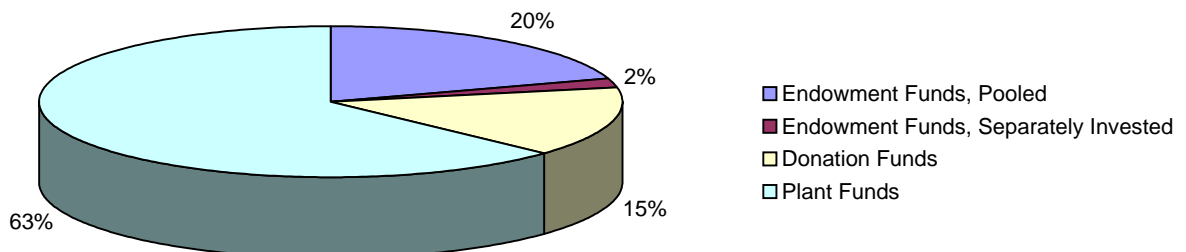
**TOTAL RETURN** – Percentage of investment return based on the total of yield, plus appreciation or minus depreciation, minus expenses incurred in management of the fund.

**YIELD** – Dividends, interest and other forms of ordinary income. “Yield” does not include principal appreciation. Dividends are included when paid and interest as it is earned, regardless of when paid.

**OREGON UNIVERSITY SYSTEM**  
**INVESTMENT SUMMARY - ALL FUNDS**  
 June 30, 2004

Funds	Market Value
<b><i>ENDOWMENT FUNDS</i></b>	
Endowment Funds, Pooled	\$ 59,563,626
Endowment Funds, Separately Invested	3,273,914
<b>TOTAL</b>	<b>62,837,540</b>
<b><i>CURRENT DONATION FUNDS</i></b>	
Donation Funds	44,801,695
<b><i>PLANT FUNDS</i></b>	
Bond Building Funds, XI-F(1)	77,738,872
Bond Building Funds, XI-G	26,660,020
Bond Sinking Funds, XI-F(1)	54,781,343
Bond Sinking Funds, XI-G	29,476
Bond Sinking Funds, Isolation Facilities	1,834,463
Building Repair & Equipment Replacement Reserves	24,428,407
<b>TOTAL</b>	<b>185,472,581</b>
<b>TOTAL ALL FUNDS</b>	<b>\$ 293,111,816</b>

**Total Investments By Fund**

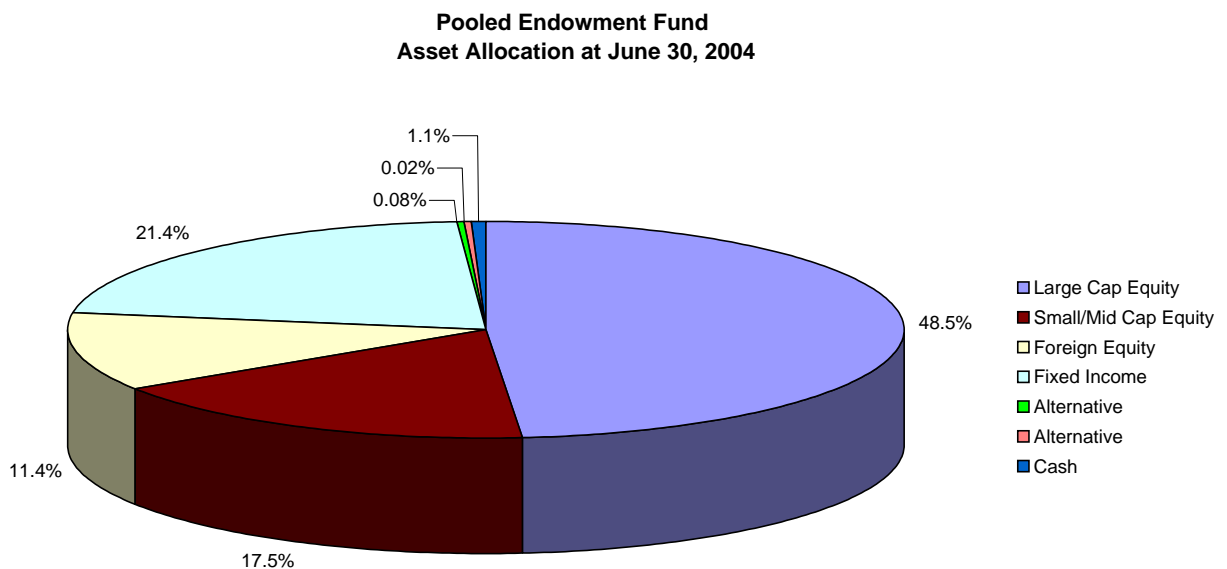


# Endowment Funds

- Pooled
- Separately Invested

**OREGON UNIVERSITY SYSTEM  
POOLED ENDOWMENT FUNDS SUMMARY  
YEAR ENDED JUNE 30, 2004**

Fund Manager	Type	Allocation Percentage	Allocation Range(1)	Market Value June 30, 2004	Return for 2004
<b>Equity</b>					
BGI Alpha Tilts Fund B	Large Cap Equity	48.5%	39%-53%	\$28,892,273	17.8%
Batterymarch	Small/Mid Cap Equity	17.5%	11%-18%	10,369,386	28.4%
T. Rowe Price Foreign Equity Fund	Foreign Equity	11.4%	7%-14%	6,789,969	24.1%
<b>Total Equity</b>		<b>77.4%</b>	<b>60%-80%</b>	<b>46,051,628</b>	<b>21.1%</b>
<b>Fixed Income</b>					
Western Asset Core Plus Bond Fund	Fixed Income	21.4%	20%-30%	12,799,545	2.7%
<b>Alternative</b>					
Commonfund Endowment Partners	Alternative	0.02%	0%-10%	6,568	149.0%
Commonfund Endowment Venture Partners	Alternative	0.08%	0%-10%	33,941	2.2%
<b>Total Alternative</b>		<b>0.10%</b>		<b>40,509</b>	<b>75.6%</b>
<b>Cash</b>					
Oregon State Treasury Float Pool	Cash	1.1%	0%-10%	671,944	1.3%
<b>Total Pooled Endowment Fund</b>		<b>100.0%</b>		<b>59,563,626</b>	<b>16.0%</b>
<b>Historical Book Value</b>				<u>26,732,783</u>	
<b>Net Appreciation to Date</b>				<u>\$32,830,843</u>	



(1) Per Board policy.

**OREGON UNIVERSITY SYSTEM**  
**ENDOWMENT FUNDS BY INSTITUTION**  
As of June 30, 2004

	POOLED		SEPARATELY INVESTED		Total
	True Endowments	Quasi- Endowments	True Endowments	Quasi- Endowments	
Eastern Oregon University	\$ 883,545	\$ 324,629	\$ -	\$ -	\$ 1,208,174
Oregon Institute of Technology	-	229,257			229,257
Oregon State University	2,068,140	26,408,450	3,199,747	2	31,676,339
Portland State University	1,292,814	757,223	1	-	2,050,038
Southern Oregon University	261,033	248,945	-	-	509,978
University of Oregon	19,631,793	5,332,745	74,159	5	25,038,702
Western Oregon University	8,030	51,772	-	-	59,802
Chancellor's Office	2,007,223	58,027	-	-	2,065,250
<b>Total Endowment At Market Value</b>	<b>\$ 26,152,578</b>	<b>\$ 33,411,048</b>	<b>\$ 3,273,907</b>	<b>\$ 7</b>	<b>\$ 62,837,540</b>

**OREGON UNIVERSITY SYSTEM**  
**POOLED ENDOWMENT FUNDS RECONCILIATION**  
 YEAR ENDED JUNE 30, 2004

	Market Value 07-01-03	Contribution (Withdrawal)	Appreciation (Depreciation)	Market Value 06-30-04	Income	Investment Fees
<b>POOLED INVESTMENTS</b>						
Western Asset Core Plus Bond Fund	\$ 13,444,698	\$ -	\$ (645,153)	\$ 12,799,545	\$ 990,196	\$ 57,598
BGI Alpha Tilts Fund B	24,881,438	-	4,010,834	28,892,272	458,797	66,263
Batterymarch (Small/Mid Cap Fund)	8,204,172	-	2,165,214	10,369,386	161,011	92,188
T. Rowe Price Foreign Equity Fund	5,572,966	-	1,217,003	6,789,969	121,151	46,979
Commonfund Endowment Prtnrs Fund	14,363	(24,509)	16,714	6,568	-	-
Commonfund Endowment Venture Prtnrs	41,691	(5,062)	(2,688)	33,941	2,952	-
<b>TOTAL Pooled Investments</b>	<b>52,159,328</b>	<b>(29,571)</b>	<b>6,761,924</b>	<b>58,891,681</b>	<b>1,734,107</b>	<b>263,028</b>
Cash Invested in State Treasury's Short-Term Investment Pool	1,310,371 (1)	(638,426)	-	671,945 (2)	18,079	-
<b>TOTAL Pooled Endowment Funds</b>	<b>\$ 53,469,699</b>	<b>\$ (667,997)</b>	<b>\$ 6,761,924</b>	<b>\$ 59,563,626</b>	<b>\$ 1,752,186</b>	<b>\$ 263,028</b>

**POOLED ENDOWMENT FUNDS ANNUAL PERFORMANCE SUMMARY**

Portfolio Market Value Gains (Losses)	\$ 6,761,924
Net Income (Int/Div income less investment fees)	<u>1,489,158</u>
<b>Total Return</b>	<u><b>\$ 8,251,082</b></u>
Annual Rate of Return (Based on Total Return)	16.0%

**Cash Reconciliation**

Cash Balance, June 30, 2003	\$ 1,310,371 (1)
New Endowments Received	3,898
Distribution to Institutions	(2,357,818)
Return of Capital from Investment Activity	29,571
Income from Investments	1,752,186
Management Fees Paid in Cash	<u>(66,263)</u>
Cash Balance, June 30, 2004	<u><b>\$ 671,945 (2)</b></u>

**OREGON UNIVERSITY SYSTEM**  
**POOLED ENDOWMENT FUNDS**  
**PERFORMANCE COMPARISONS**  
(Based on Total Return)

	Annual Performance				
	99-00	00-01	01-02	02-03	03-04
<b>Total Endowment</b>					
OUS Total Endowment	12.0%	-6.4%	-5.2%	4.5%	16.0%
Target Allocation Policy Benchmark (1)	9.2%	-7.7%	-9.0%	2.5%	15.7%
NACUBO, Pools \$00m to \$75m	9.7%	-3.7%	---	---	---
NACUBO, Pools \$51m to \$100m			-6.4%	2.7%	14.7%
<b>U.S. Equity (Stock) Investments</b>					
Total US Equity	12.6%	-9.4%	-10.5%	2.2%	20.6%
<i>Benchmark</i> - Russell 3000 Index	9.6%	-13.9%	-17.3%	0.8%	20.5%
BGI Alpha Tilts Fund B	12.0%	-12.2%	-17.6%	1.8%	17.8%
<i>Benchmark</i> - S&P 500 Stock Index	7.2%	-14.8%	-18.0%	0.2%	19.1%
Batterymarch (Small/Mid Cap Allocation Fund)	---	5.0% (2)	5.7%	3.3%	28.4%
<i>Benchmark</i> - Russell 2500 Index	---	3.9% (2)	-7.6%	1.4%	32.2%
BGI Russell 2000 Index Fund B	14.3%	-5.9% (2)	---	---	---
<i>Benchmark</i> - Russell 2000 Index	14.3%	-5.9% (2)	---	---	---
<b>Foreign Equity (Stock) Investments</b>					
T. Rowe Price Foreign Equity	24.0%	-27.3%	-10.0%	-8.0%	24.1%
<i>Benchmark</i> - EAFE Index	17.2%	-23.6%	-9.5%	-6.5%	32.3%
<b>Fixed Income (Bond) Investments</b>					
Commonfund Multi-Strategy Bond Fund	3.0%	7.7%	6.8% (2)	---	---
<i>Benchmark</i> - Lehman Aggregate Bond Index	4.6%	11.2%	6.8% (2)	---	---
Western Asset Core Plus Bond Fund	---	---	-0.4% (2)	14.1%	2.7%
<i>Benchmark</i> - Lehman Aggregate Bond Index	---	---	1.7% (2)	10.4%	0.3%
<b>Other Investments</b>					
Real Estate Investment Trust	10.8%	11.0%	---	---	---
Endowment Energy Partners	-2.5%	0.1%	---	---	---
Endowment Partners Fund	-16.3%	-9.4%	93.6%	-38.8%	149.0%
Endowment Venture Partners	84.8%	-27.5%	-40.9%	5.1%	2.2%

(1) Target Allocation Policy Benchmark is 59.5% Russell 3000 Index, 10.5% MSCI EAFE Index, 25.0% Lehman Aggregate Index and 5.0% 90 Day T-Bills.

(2) Returns for funds (and their benchmarks) which were bought or sold during the year are for a partial year.

Note: Returns in red underperformed their benchmark.

**OREGON UNIVERSITY SYSTEM**  
**POOLED ENDOWMENT FUNDS**  
**PERFORMANCE COMPARISONS**  
As of June 30, 2004  
(Based on Total Return)

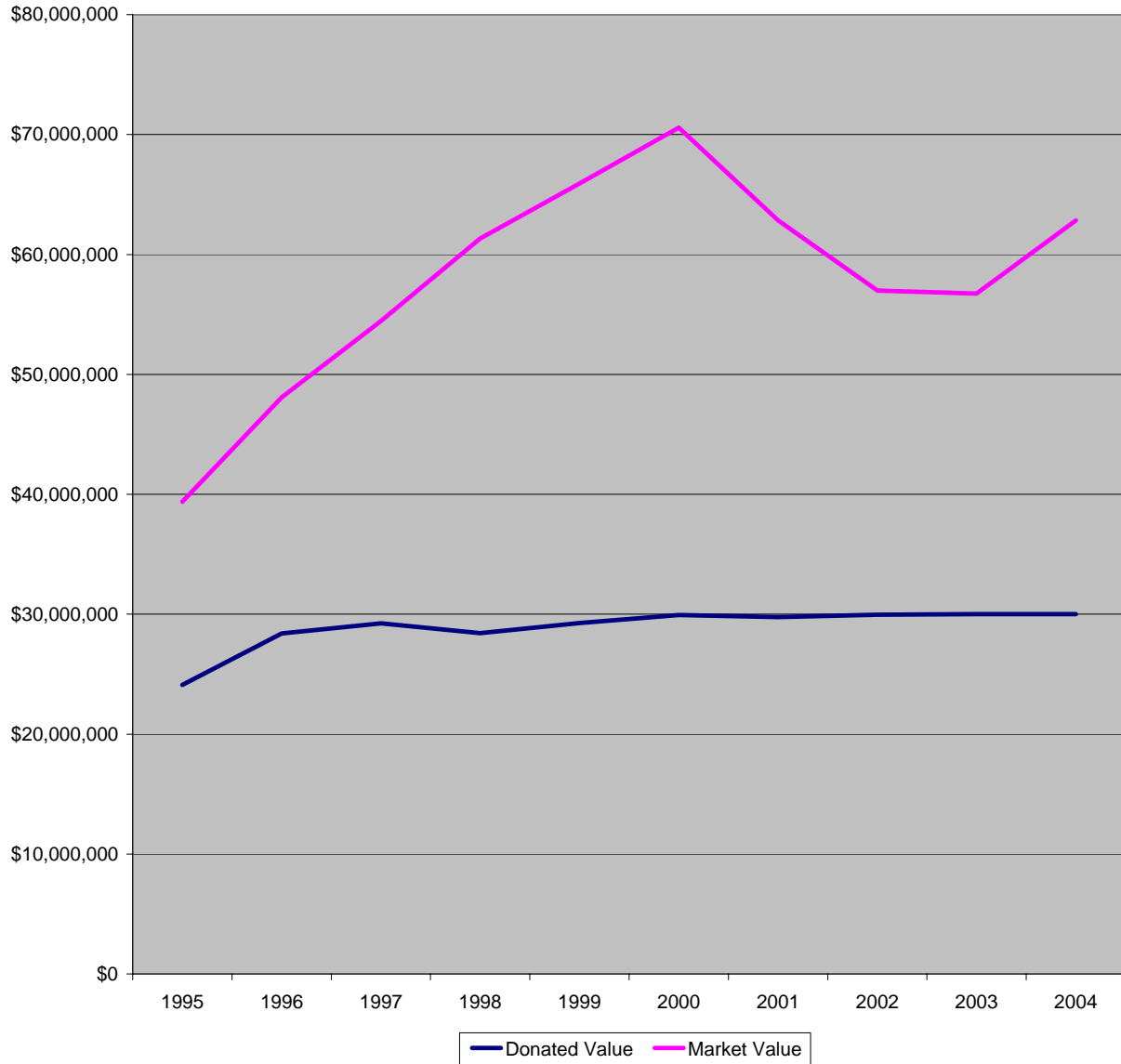
	3 Yr Avg	5 Yr Avg	10 Yr Avg
<b><i>Total Endowment</i></b>			
OUS Total Endowment	4.3%	3.7%	9.9%
Target Allocation Policy Benchmark	2.1%	1.3%	9.5%
<b><i>Total Equity (Stock) Investments</i></b>			
OUS Equity	5.0%	2.9%	<b>11.0%</b>
Benchmark - S&P 500 Stock Index	-0.7%	-2.2%	11.8%
<b><i>Fixed Income (Bond) Investments</i></b>			
OUS Fixed Income	7.6%	<b>6.7%</b>	7.7%
Benchmark - Lehman Aggregate Bond Index	6.4%	7.0%	7.4%
<b><i>Other Investments</i></b>			
Endowment Partners Fund	67.9%	35.6%	23.7%
Endowment Venture Partners	-11.2%	4.7%	22.9%

Note: Returns in red underperformed their benchmark.

**OREGON UNIVERSITY SYSTEM**  
**SCHEDULE OF INVESTMENTS - SEPARATELY INVESTED ENDOWMENT FUNDS**  
**JUNE 30, 2004**

Funds	Market Value
<i><b>ENDOWMENT FUNDS - Separately Invested</b></i>	
<i><b>Mutual Fund</b></i>	
VanGuard Intermediate Fund-U.S. Treasury	\$ 59,171
<i><b>Mortgages, Notes, and Contracts</b></i>	
Herman David Estate-Wong Contract	14,987
<i><b>Real Property</b></i>	
Cameron, Elizabeth Starker	2,805,977
Roth - Science of Botany and Plant Pathology Graduate Scholarship	393,766
<b>TOTAL Real Property</b>	<u>3,199,743</u>
<i><b>Trust Remainder Interests</b></i>	
Baney, Hope	1
Bowen, Gwladys	1
Colburn, Ruth R.	2
Fink, Richard	1
Howe, H V (Dunbar)	1
Layman, George M.	1
MacMaster, Allan Ray (McPherson)	1
Pierce, Elizabeth	2
Pierce, Ralph	2
Robertson, Vada	1
<b>TOTAL Trust Remainder Interests</b>	<u>13</u>
<b>TOTAL Endowment Funds, Separately Invested</b>	<u><u>\$ 3,273,914</u></u>

**Oregon University System**  
**Total Endowment Fund Historical Comparison**  
As of June 30, 2004



# Current Donation Funds

**OREGON UNIVERSITY SYSTEM**  
**SCHEDULE OF INVESTMENTS - CURRENT DONATION FUNDS**  
 June 30, 2004

<b>Cash Reserves</b>		
Cash Invested in State Treasury's Short-Term Investment Pool	(a)	<u>\$ 44,801,695</u>
<b>TOTAL Current Donation Funds</b>		<u>\$ 44,801,695</u>

(a) Fiscal Year Average Cash Balance Participating in the Short-Term Investment Pool

<u>Fund</u>	<u>Average Balance</u>	<u>Average Interest Rate</u>
Donation Fund	\$ 39,835,660	1.280%

# Plant Funds

**OREGON UNIVERSITY SYSTEM**  
**SCHEDULE OF INVESTMENTS - PLANT FUNDS**  
**JUNE 30, 2004**

Funds	Market Value
<b>PLANT FUNDS</b>	
A. Bond Building Funds, XI-F(1) Cash Invested in State Treasury's Short-Term Investment Pool	\$ 77,738,872
B. Bond Building Funds, XI-G Cash Invested in State Treasury's Short-Term Investment Pool	26,660,020
C. Bond Sinking Funds, XI-F(1) Cash Invested in State Treasury's Short-Term Investment Pool	54,781,343
D. Bond Sinking Funds, XI-G Cash Invested in State Treasury's Short-Term Investment Pool	29,476
E. Bond Sinking Funds, Isolation Facilities Cash Invested in State Treasury's Short-Term Investment Pool	1,834,463
F. Building Repair and Equipment Replacement Reserves Cash Invested in State Treasury's Short-Term Investment Pool	<u>24,428,407</u>
<b>TOTAL PLANT FUNDS</b>	<u><u>\$ 185,472,581</u></u>

**Fiscal Year Average Cash Balance Participating in the Short-Term Investment Pool**

<u>Fund</u>	<u>Average Balance</u>	<u>Average Interest Rate</u>
A Bond Building, XI-F(1)	\$ 41,075,681	1.280%
B Bond Building, XI-G	\$ 42,904,035	1.280%
C Bond Sinking, XI-F(1)	\$ 37,661,231	1.280%
D Bond Sinking, XI-G	\$ 25,121	1.280%
E Bond Sinking, Isolation	\$ 1,822,052	1.280%
F Bldg Repair & Equip Replacement	\$ 24,226,191	1.280%